STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations***
Paper topic	Further analysis using more complex fact patterns

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Introduction

1. As mentioned in Agenda Paper 3, the IFRS Interpretations Committee (the 'Interpretations Committee') discussed two issues relating to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* at its September 2013 meeting. The two issues are as follows:

   (a) **Issue 1**: how to recognise an impairment loss for a disposal group when the difference between its carrying amount and its fair value less costs to sell exceeds the carrying amount of non-current assets in the disposal group; and

   (b) **Issue 2**: how to account for the reversal of an impairment loss for a disposal group when the reversal relates to an impairment loss recognised for goodwill.

2. The Interpretations Committee did not reach a consensus on these issues and therefore asked the staff to:

   (a) (**Request 1**) look at these issues along with other IFRS 5 issues that the IASB had previously considered but not addressed;

   (b) (**Request 2**) consult current and former IASB staff and members who were involved with the development of IFRS 5; and

(c) (**Request 3**) analyse the issues discussed using more complex fact patterns that further illustrate the interaction between non-current assets, current assets and liabilities in the disposal group.

3. This paper addresses **Request 3** as noted above, by analysing the issue using more complex fact patterns.

Staff analysis

4. We note that Request 3 specifically relates to Issue 1 and therefore we explore complex fact patterns by modifying the submitter's example illustrated for Issue 1 (ie the example as described in Agenda Paper 3A for this meeting).

5. The submitter's example assumed that:

   (a) an entity clearly identifies the source of decrease in the fair value of the disposal group;

   (b) a fair value of fixed-rate borrowings increased significantly; and

   (c) a change in the fair value of the disposal group is only due to an increase of fixed-rate borrowing.

6. However, we note that IFRS 5 does not require an entity to identify the source of decrease in fair value of a disposal group when measuring the disposal group at fair value less cost to sell (FVLCTS). We therefore think that there could be a circumstance in which an entity can only measure a disposal group as a whole at FVLCTS as opposed to being able to measure each individual asset and liability separately, as in the submitter's example.

7. To consider such a circumstance, we assume the following fact patterns.

   (a) Entity Alpha intends to sell one of its subsidiaries, Entity Beta. Entity Alpha's intended sale of Entity Beta meets the IFRS 5 criteria for classification of Entity Beta ('Disposal group Beta') as held for sale. The assets and liabilities of Disposal Group Beta consist of goodwill, items of property, plant and equipment, inventory, borrowing and warranty provisions. The carrying amount of assets and liabilities before re-measuring the disposal group is as follows.

	Carrying amount at the end of the reporting period before classification as held for sale	**Carrying amount as remeasured immediately before classification as held for sale**[1]
	CU[2]	CU
Goodwill	100	100
Property, plant and equipment	700	500
Inventory	400	300
Total	1,200	900
Borrowing	(50)	(50)
Warranty provisions	(350)	(150)
Total	(400)	(200)
Net assets	800	700

[1] Paragraphs 18 and 19 of IFRS 5 require that:

18 Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable IFRSs.

19 On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of IFRS 5, but are included in a disposal group classified as held for sale should be remeasured in accordance with applicable IFRSs before the FVLCTS of the disposal group is remeasured.

[2] In this Agenda Paper, currency amounts are denominated in ‘currency units’ (CU).

(b) As noted, the carrying amount of Disposal Group Beta's net assets subsequent to the application of all Standards other than IFRS 5 is CU700. For measurement purposes of IFRS 5, FVLCTS is determined to be (CU1,200),[3] being the fair value of Disposal Group Beta's net assets / (liabilities) of (CU1,190) and costs to sell of CU10; the entity cannot identify the source of the decline of fair value.

8. In this circumstance, we consider two situations:

(a) **Situation 1:** Entity Alpha is committed to a sale plan, the sale is highly probable, but has not entered into a binding contract with a (potential) buyer; and

(b) **Situation 2:** Entity Alpha entered into a binding contract with a buyer of the disposal group, whereby Entity Alpha pays the buyer for taking Disposal Group Beta; and the payment amount is fixed at the fair value amount when the FVLCTS of Disposal Group Beta is measured at (CU1,200) as noted in the example.

9. We think that the accounting by Entity Alpha would differ depending on Situation 1 or 2. We think that in Situation 1, Entity Alpha would not recognise a liability; in contrast, in Situation 2, Entity Alpha would recognise a liability because its obligation to pay to a buyer of Disposal Group Beta would meet the requirements for recognising a provision for onerous contract in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

10. In addition, we think that a provision for onerous contract in Situation 2 would be established after Entity Alpha recognises any impairment loss by reducing the assets in the disposal group in accordance with IFRS 5. This is because paragraph 69 of IAS 37 states that an entity recognises any impairment loss that has occurred on assets dedicated to that contract before a separate provision for an onerous contract is established.

[3] In this example, figures in brackets indicate a negative value.

11. Taking into account these two situations, we examine how an entity would recognise an impairment loss under the four views that were identified by the submitter as described in Agenda Paper 3A for this meeting.

(a) **Alternative A:** limit an impairment loss to non-current assets that are within the scope of the measurement requirements of IFRS 5;

(b) **Alternative B**: limit an impairment loss to net assets of a disposal group;

(c) **Alternative C:** limit an impairment loss to the total assets of a disposal group; and

(d) **Alternative D:** limit an impairment loss to non-current assets and recognise a liability in order to measure the disposal group at FVLCTS.

Alternative A: limit an impairment loss to non-current assets that are within the scope of the measurement requirements of IFRS 5

12. Alternative A would be supported by paragraph 23 of IFRS 5, which states that the impairment loss should be allocated to the non-current assets in the disposal group that are within the scope of the measurement requirements of IFRS 5.

13. Accordingly, in Situation 1, Entity Alpha would allocate an impairment loss only to the carrying amount of goodwill and an item of property, plant and equipment (PPE) by reducing those amounts to zero. In Situation 2, Entity Alpha, after recognising the impairment loss, would recognise a liability of CU1,300 in accordance with IAS 37.

14. Consequently, Entity Alpha in Alternative A would measure Disposal Group Beta as follows:

	FVLCTS in Situation 1	FVLCTS in Situation 2
	CU	CU
Goodwill	–	–
Property, plant and equipment	–	–
Inventory	300	300
Total	300	300
Borrowing	(50)	(50)
Warranty provisions	(150)	(150)
Liability	–	(1,300)
Total	(200)	(1,500)
Net assets	100	(1,200)

Alternative B: limit an impairment loss to net assets of a disposal group

15. Alternative B would be based on paragraph 15 of IFRS 5, which states that the disposal group should be measured at the lower of its carrying amount and FVLCTS. However, Alternative B assumes that the disposal group cannot be measured at a negative amount (ie credit balance).

16. Accordingly, in Situation 1, Entity Alpha would allocate an impairment loss to the carrying amount of goodwill, PPE and inventory, which results in the net asset amount of Disposal group Beta being zero. In Situation 2, Entity Alpha, after recognising the impairment loss, would recognise a liability of CU1,200 in accordance with IAS 37.

17. Consequently, Entity Alpha in Alternative B would measure Disposal Group Beta as follows:

	FVLCTS in Situation 1	FVLCTS in Situation 2
	CU	CU
Goodwill	–	–
Property, plant and equipment	–	–
Inventory	200	200
Total	200	200
Borrowing	(50)	(50)
Warranty provisions	(150)	(150)
Liability	–	(1,200)
Total	(200)	(1,400)
Net assets	–	(1,200)

Alternative C: limit an impairment loss to the total assets of a disposal group

18. A rationale for Alternative C would be based on paragraph 23 of IFRS 5. Moreover, we think that Alternative C is supported by paragraph BC41 of IFRS 5, which describes that IFRS 5 was drafted to require the same allocation of the impairment loss for the disposal group as is required by IAS 36 *Impairment of Assets* for cash-generating units.

19. Accordingly, although paragraph 23 of IFRS 5 refers to the requirements of IAS 36 only in terms of the order of allocation of an impairment loss, proponents of Alternative C would point out that IFRS 5 should be consistent with IAS 36 in terms of the allocation of an impairment loss. In this regard, we note that IAS 36 requires:

(a) an entity to reduce the carrying amount of an asset with a limitation of zero[4] and then the amount of the impairment loss that would otherwise have been allocated to the asset is allocated pro rata to the other assets of the cash-generating unit (see paragraph 105 of IAS 36); and

(b) a liability to be recognised for any remaining amount of an impairment loss for the cash-generating unit if, and only if, that is required by another Standard (see paragraph 108 of IAS 36).

20. Consequently, if IFRS 5 is to be consistent with IAS 36 in terms of allocation of an impairment loss, an impairment loss would need to be allocated to other assets of the disposal group that are not within the measurement requirements of IFRS 5.

21. In Situation 1, Entity Alpha would allocate an impairment loss by reducing the carrying amounts of the total assets of Disposal Group Beta to zero. In Situation 2, Entity Alpha, after recognising the impairment loss, would recognise a liability of CU1,000 in accordance with IAS 37.

22. Consequently, Entity Alpha in Alternative C would measure Disposal Group Beta as follows:

[4] Paragraph 105 of IAS 36 describes that an entity shall not reduce the carrying amount of an asset below the highest of: (a) its FVLCTS (if measurable); (b) its value in use (if determinable); and (c) zero.

	FVLCTS in Situation 1	FVLCTS in Situation 2
	CU	CU
Goodwill	–	–
Property, plant and equipment	–	–
Inventory	–	–
Total	–	–
Borrowing	(50)	(50)
Warranty provisions	(150)	(150)
Liability	–	(1,000)
Total	(200)	(1,200)
Net assets	(200)	(1,200)

Alternative D: limit an impairment loss to non-current assets and recognise a liability in order to measure the disposal group at FVLCTS

23. Alternative D would be supported by paragraph 15 of IFRS 5, which states that a disposal group classified as held for sale should be measured at the lower of its carrying amount and FVLCTS. In addition, proponents of Alternative D would also suggest that it is consistent with paragraph 23 of IFRS 5 in that an impairment loss is allocated only to non-current assets that are within the measurements requirements of IFRS 5.

24. As opposed to Alternatives A–C, the accounting of Entity Alpha would not be different depending on Situations 1 and 2 because Entity Alpha would recognise Disposal Group Beta at a negative amount (ie credit balance), regardless of whether it is in Situations 1 or 2. Accordingly, we think that a

liability in Alternative D is recognised in accordance with IFRS 5, and not recognised in accordance with IAS 37.

25. Consequently, Entity Alpha in Alternative D would measure Disposal Group Beta as follows:

	FVLCTS in Situation 1	**FVLCTS in Situation 2**
	CU	CU
Goodwill	–	–
Property, plant and equipment	–	–
Inventory	300	300
Total	300	300
Borrowing	(50)	(50)
Warranty provisions	(150)	(150)
Liability	(1,300)	(1,300)
Total	(1,500)	(1,500)
Net assets	(1,200)	(1,200)

Staff view

26. We continue to support **Alternative A**, consistently with our view as suggested in the staff paper to the September 2013 Interpretations Committee meeting (Agenda Paper 10A). In that staff paper, we noted that in our view:

(a) paragraphs 15 and 23 of IFRS 5 are not contradictory because paragraph 15 sets out the principle while paragraph 23 sets a limitation to the application of that principle; and

(b) such a limitation is also found in IAS 36 (ie paragraph 59 of IAS 36 sets out a measurement principle which is limited by paragraph 62 of IAS 36).

27. We think that Alternatives B and C would be inappropriate. This is because an impairment loss is allocated to the assets that are not within the scope of the measurement requirements of IFRS 5 (ie inventory in the example), which would contradict paragraph 23 of IFRS 5 that requires an impairment loss to reduce non–current assets in the disposal group that are within the scope of the measurement requirements of IFRS 5. We also think that Alternative D would be inappropriate because we think that in the example above, recognising an additional liability in order to measure the disposal group at FVLCTS would be at odds with the requirements of other Standards.

Question for Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis that: (a) the accounting could differ depending on Situations 1 and 2; and (b) Alternative A would be most appropriate?